United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

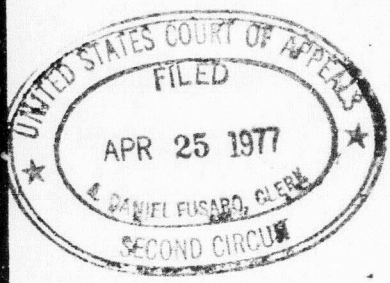
77-5003

To be argued by
ANTHONY J. D'AURIA

IN THE

United States Court of Appeals

FOR THE SECOND CIRCUIT



Docket No. 77-5003

IN RE
THE FABRIC TREE,
Debtor-Appellee.

MANGEL STORES CORPORATION,
Appellant.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF MANGEL STORES CORPORATION, APPELLANT

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REPLY BRIEF OF MANGEL STORES CORPORATION, APPELLANT

A. Appellees' Position Lacks Support in the Record.

The infirmity of the proceeding below is nowhere better demonstrated than in the opposing briefs. At every critical juncture where an evidentiary citation is called for to support a proposition advanced in the briefs or a finding made by the courts, the briefs are silent. Indeed the rationale of the opposing briefs appears to be that the opinions below must be affirmed because they are the opinions below and that the findings made below are best supported by reference to the findings themselves.

But Mangels' brief challenged the evidentiary basis for those findings which were at the very heart of the courts' opinions. Thus Mangels demonstrated that there was no

support for the findings that it was motivated by bad faith and lack of candor; or that it hindered performance of the contractual conditions; or that it had determined to escape from the contract; or that the delay in confirmation was of its own making; or that it had controlled Fabric Tree's operation and the confirmation process; or that it had decided to convert all of Fabric Tree's stores to apparel stores; or that the commitments for fall inventory had been made prior to July 15, or that its decision to suspend its guaranty of purchase just prior to July 15 had an adverse impact on Fabric Tree's business; or that it intentionally waived its rights under the contract; or that the July 15 date was not intended to be of the essence.

The opposing briefs chose not to come to grips with Mangels' showing of lack of record support for these findings and have been satisfied merely to reiterate them. But this approach hardly is persuasive and leaves unresolved one of the principal contentions raised by Mangels on this appeal, namely, that the record does not support those findings.

What is more, the brief of the Creditors Committee distorts those facts about which there can be no legitimate dispute. The Committee would have this court believe that on July 15, 1976, Fabric Tree was ready, willing and able to proceed to confirmation in accordance with conditions established in the agreement with Mangels. But this was simply not the case, as Fabric Tree itself acknowledged in its brief:

> "On July 15, 1976, Fabric Tree, through its counsel, advised the Court that it was not in a position to submit an Order of Confirmation because the debtor had apparently been unable to reduce general unsecured claims to such an amount as would necessitate a deposit of no more than $450,000 to pay 15% of them. In addition, administration and priority expenses exceeded $150,000 as at July 15, 1976." (Fabric Tree Brief, pp. 9-10.)

There can be no question, then, but that Fabric Tree was not capable of fulfilling the contract on the day fixed for performance and that this incapacity resulted not from anything Mangels did or failed to do, but from Fabric Tree's own inability to meet the monetary conditions of the contract.

The Committee attempts to soften the impact of this default by urging that Mangels' presence in court on July 13, when professional fees were fixed, amounts to an estoppel. It is true that fees were fixed on that day. But it is also true that Fabric Tree represented to the court that it was prepared to proceed to confirmation (Committee Brief, page 8). In light of that representation there was nothing Mangels could or should have said. If indeed the representation made to the court by Fabric Tree were correct, then Mangels would have honored its part of the contract. What Mangels did not know on July 13 was that two days later Fabric Tree would announce to the court that it had not met the monetary conditions of the contract.

Nevertheless, in a tautology that defies analysis, the Committee now argues that Mangels should be penalized for not perceiving that the representations made to the court by Fabric Tree on July 13 were false and that somehow or other Mangels should bear the responsibility for a misrepresentation it did not make.

This deliberate attempt to cast Mangels in the role of a malefactor is evident throughout the opposing briefs. Both appellees contend that the cancellation by Mangels of its guaranty of Fabric Tree's purchases just prior to July 15 (A. 159) hindered or delayed the confirmation. But nowhere do appellees attempt to connect that cancellation with Fabric Tree's inability to meet the monetary conditions or to show how one was the result of the other. No evidence is pointed to demonstrating when the merchandise would have been received, when and at what price it could have

been sold and what effect the sale thereof would have had on Fabric Tree's undertaking to meet the monetary conditions. Nor do appellees explain how they were able to become "unhindered" on July 27. Instead appellees merely argue that Mangels hindered compliance and ignore what even Judge Lesser acknowledged: that Mangels was entirely justified in limiting its exposure at the end (A. 292).

Appellees' assertions that Mangels "became disenchanted" with the acquisition of Fabric Tree suffers from the same lack of evidentiary support. One searches the record in vain for any evidence to support so substantial a charge. In fact, that charge is directly controverted by Mangels' unrebutted testimony that it would have consummated the transaction if the monetary conditions had been met (A. 180).

Equally distorted is appellees' claim that Mangels so "controlled the confirmation process" that it was itself responsible for the failure to meet the monetary conditions by July 15. In the view of appellees, the appearance of Mangels on the scene as a potential financer transferred to Mangels all of the statutory duties and responsibilities in connection with the confirmation of a plan which the Bankruptcy Act and Rules places upon the debtor and the creditors committee. Thus, according to appellees, Mangels became responsible for fulfilling the contractual prerequisites for confirmation, for overseeing the consent and certification process, for informing the court and the committee as to the status of that process, and for insuring the accuracy of representations made to the court by the debtor and the creditors committee. The mere statement of this position demonstrates its absurdity.

Similarly, appellees suggest that if Mangels is successful on this appeal it will reap an unwarranted windfall as a result of the security interest obtained by Mangels in the assets of Fabric Tree. But, what appellees have failed to state is that the security interest was part of a separate agreement by Mangels to advance credit to Fabric Tree;

that pursuant to that agreement Mangels loaned $700,000 to permit the purchase of inventory; and that when it became necessary to realize on the security interest, Mangels obtained only $400,000 payable over time, sustaining a loss of at least $300,000. Thus, far from profiting from the transaction, Mangels has incurred substantial losses.

And, it was precisely because it wanted to limit these losses that Mangels insisted on a July 15 performance day. Appellees have strained to offer any number of reasons why that date should not be and ought not to have been considered a critical one by Mangels. But what they failed to address is the fact, amply demonstrated, that at the time of the execution of the contract, Mangels intended time to be of the essence. In fact, the contract specifically established July 15 as the outside performance date and further provided that the certificate of deposit would be returned to Mangels if there were no performance by that date. There can be no clearer evidence of the intention of the parties at the time the contract was executed. And that is the only test to be applied. Any other would make every contract performance date a moving target, dependent upon the vicissitudes of events as they developed after the contract was signed rather than upon what the parties intended at the time it was signed.

Thus, the factors pointed to by appellees as to why time should not have been of the essence are not only undocumented and contrary to the written agreement, but quite beside the point. For whether Mangels controlled the confirmation process (and it did not) and whether it was interested in only the debtor's leases (and it was not) and whether the debtor was projected to have a loss through August (which only lends further support to Mangels' desire for an early takeover) and whether peak inventory commitments had been made by July 15 (and they had not) are not elements to be considered in determining the intention of the parties at the time the contract was executed. For that, reference must be had to the circum-

stances then existing and the language of the contract itself, reference points which have been studiously avoided by appellees. When the origins of the transactions and Mangels' uncontroverted testimony are considered, it is clear that the July 15 date must be enforced.

In sum, with respect to this issue as well as the others, appellees have ignored Mangels' challenge. They have established their own standards, drawn unwarranted inferences and side-stepped their lack of record support, all in an effort to give substance to their view of the case. Since they have done no more than that, they should not prevail in this appeal.

B. Appellees Have Not Demonstrated a Basis for Jurisdiction.

The jurisdictional argument of both appellees begin with the unexceptional proposition that summary jurisdiction in Chapter XI proceedings is broader than in ordinary bankruptcy proceedings, citing *In Re Stockman Development Company,* 447 F.2d 387 (9th Cir. 1971). They then attempt to build on that foundation to bootstrap themselves into an argument that such jurisdiction in Chapter XI proceedings is virtually unlimited, so long as the controversy in question somehow relates to the ability of the debtor to continue in business or to propose a plan. It is submitted that neither *Stockman* nor any of the other cited cases supports such unlimited jurisdiction.

The holding in *Stockman* is a limited one. The court there held that, unlike in ordinary bankruptcy proceedings, the Chapter XI court's jurisdiction extends to property not in the possession of the debtor but to which the debtor claims title, so long as the person holding such property does not have a substantial and adverse claim of right thereto. In other words, title to property, as well as possession thereof, is sufficient to grant the court jurisdiction over that

property in Chapter XI proceedings because the jurisdictional provision of Chapter XI refers to the court's jurisdiction "of the debtor *and his property, wherever located*" Bankruptcy Act § 311, 11 U.S.C. § 711 (1970) (emphasis added). Thus *Stockman* applied the well recognized and undisputed jurisdiction over a "controversy arising in proceedings in bankruptcy," Bankruptcy Act § 2a(7), 11U.S.C. §11a(7) (1970), and is in no way a departure from basic jurisdictional principles. The appellees, however, chose to ignore the holding and focus upon language in the opinion, consistent with the context of the holding, which, they argue, justifies virtually unlimited jurisdiction in a Chapter XI case, even in the absence of a *res* to which the jurisdiction can attach. Clearly, the *Stockman* holding has no effect in this case, for the debtor does not claim a sufficient property interest in the certificate of deposit to invoke the *Stockman* principle. And the *Stockman* dictum, taken out of context and separated from the holding, cannot support the unlimited jurisdiction advocated here by the appellees.

Appellees proceed from this irrelevant starting point to an alleged demonstration that the Bankruptcy Court had jurisdiction to decide the issues brought before it on the basis of three cases: *In Re Fox Metal Industries, Inc.*, 453 F.2d 1128 (10th Cir. 1972); *Governor Clinton Co., Inc.* v. *Knott*, 120 F.2d 149 (2d Cir. 1941), *appeal dismissed*, 314 U.S. 701 (1942); and *In Re Sherman Plastering Corporation*, 340 F.2d 915 (2d Cir. 1965). But appellees fail to emphasize that the facts of these cases are different from the instant case in one very crucial respect: in each of those cases, the Bankruptcy Court asserted jurisdiction over a dispute arising out of an agreement between a third party and a court-appointed fiduciary in charge of the daily administration of the case on the court's behalf, and each dispute in question involved monies of the estate or due to the estate. The distinction is crucial, for those cases simply fall within the well-recognized jurisdictional umbrella of

"proceedings in bankruptcy." (See Mangels' original brief, Point I.) Without comparable facts in this case, a finding of bankruptcy court jurisdiction would constitute an unprecedented extension of summary jurisdiction to an entirely new class of matters: those wherein the exercise of jurisdiction by the bankruptcy court would be convenient to the debtor. No such basis of jurisdiction exists, and the extension of jurisdiction to this case would virtually eliminate any further limitation whatsoever upon the summary jurisdiction of the bankruptcy court. The only conclusion that one could reach from a jurisdictional decision in appellees' favor in this case is that a bankruptcy court has jurisdiction over any matter which the debtor chooses to bring to the attention of that court. Such a result should not be countenanced.

Apparently in recognition of this problem, the creditors committee attempts to build an alternative argument that by delivery of the certificate of deposit to the chairman of the creditors committee in escrow, Mangels consented to the jurisdiction of the bankruptcy court. The argument seems to be that the chairman of the creditors committee is an officer of the court, and thereby the delivery was to the court itself. This argument was made to Judge Werker below, who chose not to mention it in his opinion upholding jurisdiction, for the fact of the matter is that appellees cannot provide a single citation for the proposition that the chairman of the creditors committee is an officer of the court.

The functions of a creditors committee in a Chapter XI case are catalogued in Bankruptcy Rule 11-29(a). which provides:

> "The committee selected pursuant to Rule 11-27 may consult with the trustee, receiver, or debtor in pos-

> session in connection with the administration of the estate, examine into the conduct of the debtor's affairs and the causes of his insolvency or inability to pay his debts as they mature, consider whether the proposed plan is for the best interests of creditors and is feasible, negotiate with the debtor concerning the terms of the proposed plan, advise the creditors of its recommendations with respect to the proposed plan, report to the creditors concerning the progress of the case, collect and file with the court acceptances of the proposed plan, and perform such other services as may be in the interest of creditors."

It is obvious, then, that the creditors committee acts as a representative of the creditor body, and as such a representative is a party in interest to the proceeding and entitled to be heard on virtually all matters presented by the debtor to the court. 8 *Collier on Bankruptcy* ¶5.48[10](14 ed. 1976). Its primary function, in other words, is to translate the Chapter XI case from an *ex parte* proceeding of the debtor-in-possession to an adversary proceeding in which the creditors are represented in a meaningful and manageable fashion. It is, in short, a party in interest, not an administrative arm of the referee. The leading bankruptcy treatise states a committee is not an "officer" in the administration of the estate within the meaning of Bankruptcy Act § 62a. 2A *Collier on Bankruptcy* ¶44.22[4], n. 27 (14th ed. 1974).

In another context in *In re Standard Commercial Tobacco Co.*, 34 F. Supp. 304 at 309 (S.D.N.Y. 1940) the judge adopted as his own the holding of Referee Robert P. Stephenson that "I doubt whether a committee acts in a *quasi-public capacity*".

Rather, the committee represents the interests of creditors as an adversary of the debtor, no more, no less. It is

not an appendage of the bankruptcy court such that its possession of the *res* gives the court jurisdiction thereover. Furthermore, even if the specific language of §311, giving the bankruptcy court jurisdiction over "the debtor and his property, wherever located" could somehow be expanded to include property not claimed by the debtor in the hands of the committee as escrow agent, that jurisdiction cannot be larger than if the property were claimed by the debtor, and so the establishment of a more than colorable claim by Mangels would terminate that jurisdiction.

The simple fact of the matter is that the courts have consistently held that the bankruptcy court lacks jurisdiction over an escrow deposit in the hands of a third party. Judge Werker himself acknowledged that *Bayview Estates, Inc.* v. *Bayview Estates Mobile Home Owners Association,* 508 F.2d 405 (6th Cir. 1974) and *In Re H.L. Gentry Construction Co.,* 200 F.Supp. 546 (E.D. Mich. 1961), *aff'd* 314 F.2d 945 (6th Cir. 1962) are on all fours with the case at hand. Thus, he had to find an alternative theory, purportedly supported by the cases discussed *infra,* on which to base jurisdiction. But the fact remains that, in addition to the two cases admittedly on all fours, in every single instance in which a bankruptcy court has attempted to assert jurisdiction over such an escrow deposit, it has been rebuffed by a higher court. *Mid-Jersey National Bank* v. *Fidelity Mortgage Investors,* 518 F.2d 640 (3rd Cir. 1975); *Baxter* v. *United Forest Products Co., Inc.,* 418 F.2d 1120 (8th Cir. 1969), *cert. denied* 394 U.S. 1018 (1969); *Saper* v. *West,* 263 F.2d 422 (2d Cir. 1959); *United States* v. *Neiwith,* 370 F.Supp. 929 (D.N.J. 1974). Since, as demonstrated in appellant's primary brief and herein, *Fox* and the other cases relied upon by appellees are inopposite, the conclu-

sion is indisputable, as even Judge Werker admitted, that these cases are determinative of the issue at hand, and the bankruptcy court lacked jurisdiction over the instant dispute.

For all of the foregoing reasons it is respectively requested that the decision below be reversed.

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Service of three (3) copies of

the within Reply Brief is hereby admitted this

25th day of April, 1977 Hahn Hessen Margolis & Rizzo

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Service of three (3) copies of

the within Reply Brief is hereby admitted this

25th day of April, 1977

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